

April 29, 2004

MEMORANDUM

To: Janice G. Bourne
Chief Financial Officer
Fauquier Co. Government and Public Schools

From: Gary Ometer
Senior Vice President

Re: Fauquier County School Bond Referendum

In June 2001, the Fauquier County Board of Supervisors adopted a Resolution stating that “all new facility construction projects or acquisitions that exceed \$10 million shall be subject to voter referendum regardless of financing mechanism”. The new policy took effect July 1, 2002. While non-binding, the County has made this policy a part of its official debt management policies.

Fauquier County Public Schools is considering constructing a new high school as part of its capital improvement program. The cost of the new high school may be approximately \$40 million. We understand that the School Board may request that the County Board of Supervisors waive the above described referendum policy for this project. You have asked BB&T Capital Markets, as the County’s Financial Advisor, to advise the County on the financial implications of the referendum or waiver thereof.

Pursuant to the Constitution of Virginia and the Public Finance Act of 1991, a county in Virginia is authorized to issue general obligation bonds and bond anticipation notes secured by a pledge of its full faith and credit. For the payment of such general obligation bonds the governing body of the county is required to levy, if necessary, an annual ad valorem tax on all property in the county subject to local taxation. Although the issuance of bonds by Virginia counties is not subject to any limitation on amount, counties are generally prohibited from issuing general obligation bonds unless the bonds are refunding bonds or the issuance of such bonds has been approved by public referendum. Two exceptions to this rule are general obligation bonds (GOBs) sold to the State Literary Loan Fund or the Virginia Public School Authority (VPSA)¹ to finance capital projects for public schools.

¹ BB&T Capital Markets currently serves as the VPSA’s financial advisor.

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The County's Literary Fund Loan rate is currently 5% reflecting a relatively high composite index, which is used to rank loan requests on the priority waiting list. The maximum amount that may be borrowed for a specific project is \$7.5 million, subject to an aggregate cap of \$20 million in outstanding Literary Fund Loans. Given the current low level of interest rates, the County could likely achieve a lower cost of funds than a State Literary Fund Loan by borrowing through alternative vehicles. We cannot predict the level of interest rates when the County may borrow for the subject high school project, but for the purposes of this memorandum we will ignore Literary Fund Loans.

Except for bonds issued in 1993, Fauquier County has recently financed most of its school-related projects through the VPSA. The VPSA offers low-cost, user friendly and timely financing for Virginia localities. The VPSA's bonds are rated AA+/Aa1/AA+ by Fitch Ratings, Moody's Investors service and Standard & Poor's, respectively. In a VPSA borrowing the County sells its bonds to the VPSA, that in turn issues bonds to finance the purchase of the County's bonds. The VPSA charges all participants a 10 basis point fee for participating in its pooled financings. For example, if the VPSA's bonds were paying 4.00%, the County would pay the VPSA 4.10%. The 10 basis point fee covers all transaction costs other than local counsel.

As stated, the County may sell its GOBs to the VPSA absent a referendum. In the event the County's voters approved a school bond referendum, the County could choose to use the VPSA or sell GOBs publicly on its own. However, in the event of a failed referendum, VPSA policy requires that local projects may only be considered if (a) both the local governing body (County BOS) and School Board have, by majority vote, approved resolutions stating that the projects are essential and (b) either (i) the aforementioned resolutions were unanimously approved, (ii) at least two years have passed since the failed referendum, or (iii) the Virginia Department of Education has determined that an emergency exists for such project.² Thus in the case of a failed referendum, the VPSA would not be a readily available fallback option. Since advisory referendums in Virginia are not allowed, the referendum would not be advisory in nature. The question becomes whether the County may gain financial or ancillary benefit(s) from a successful bond referendum for the new project weighed against the risks of increased costs in the event of a delay resulting from a failed referendum.

We believe that Fauquier County would benefit from a successful bond referendum for this particular project. The County's general obligation bonds are rated Aa2/AA- by Moody's and Standard & Poor's, respectively. The County does not carry a Fitch rating. Thus the County's bonds are rated very closely to the VPSA's rating. While the VPSA's bonds typically sell very close to the triple-A scale, the County's bonds would also sell very well in comparison to the VPSA. The County has a very good credit rating, is

² Note: See the VPSA General Pooled Bond Policy at: <http://www.trs.state.va.us/Debt/vpsapooled.htm>.

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growing, well managed, has sound financial practices and policies, and has a history of repaying its obligations. The County does not issue bonds very often so its name has "scarcity" value. Since many institutional investors have regulatory and self-imposed limits on the percentage of their portfolio that may be held in any one name, Fauquier County's bonds would be very desirable as an uncommon name in the market.

Given the size of this project, the County would benefit from a stand-alone public sale as opposed to a VPSA pooled sale. First is that the cost of issuance required for a public sale could easily be absorbed in a sale of this size. If the size of the sale was in the \$5-\$15 million range, the VPSA would be the preferable option because the costs of issuance would exceed the VPSA's 10 basis point charge. However, in this case, the County is better off paying the costs of issuance. In addition, it has been three years since Fauquier County approached the bond rating agencies to review its ratings. Since the County has bonds outstanding and will likely issue bonds in the future to finance needed infrastructure as the County grows, it is in the County's best interest to meet with the bond rating agencies on a periodic basis. Thus, one ancillary benefit from this sale would be the opportunity to review these ratings in conjunction with a bond sale.

Finally, one of the characteristics of a well-managed locality is adherence to financial policies. This and other policies are reviewed by the bond rating agencies when they assess a locality's financial management. The County adopted its referendum policy in 2001. If the County simply waived the policy for this project it may appear that the County is not adhering to its policies although such a waiver would not likely be viewed negatively by the rating agencies, as the project is essential. In the event the County wished to make exceptions for school projects, we would suggest amending the referendum policy as opposed to a waiver. There are several options for amending the policy depending on the County's priorities and goals.

In conclusion, there are financial and other benefits available to Fauquier County by issuing GOBs to finance the high school project through a stand-alone public sale. In order to accomplish this, a referendum is required. If the County feels the benefits outweigh the risks, we would recommend that it proceed with the referendum. We are available to answer your questions as you proceed.

c: G. Robert Lee, County Administrator
Fauquier County
J. David Martin, Superintendent
Fauquier Co. Public Schools
Christopher G. Kulp, Esq.
Hunton & Williams
Peter H. Shea, Managing Director
BB&T Capital Markets

